

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

77-1369

IN THE
United States Court of Appeals
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,

Appellee,

vs.

JOSEPH L. GAY,

Defendant-Appellant.

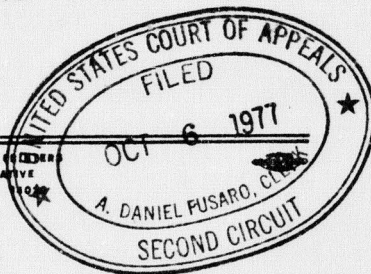
APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF NEW YORK.

BRIEF OF APPELLANT

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IN THE
United States Court of Appeals

For The Second Circuit

Docket No. 77-1369

UNITED STATES OF AMERICA,

Appellee,

vs.

JOSEPH J. GAY,

Defendant-Appellant.

Appeal From The United States District Court For The
Western District Of New York

BRIEF OF APPELLANT

Statement of Issues Presented for Review

1. Was the opening net worth established with reasonable certainty if the government did not negate probable sources of non-taxable income?
2. Was the cash on hand admission corroborated?
3. Was the existence of the cash hoard so substantially demonstrated by both the government and the defendant's case so as to create a reasonable doubt as a matter of law?

Statement of the Case

This is an appeal by the defendant, Joseph J. Gay from his conviction after a jury trial (Chief Judge John T. Curtin, presiding) of five counts of violating 26 U.S.C. § 7201 by willfully attempting to evade "a large part of the income tax due" for the years 1967 through 1971 inclusive. The defendant-appellant was indicted April 4, 1974 and his trial commenced on March 22, 1976. The jury returned a verdict of guilty on each count of the indictment on April 13, 1976. He was sentenced to probation for a period of three years and fined a total of \$35,000 (R. 927). The theory of the government throughout the case which proceeded on the "expenditures variant of the net worth theory" was that the defendant had spent more money during the indictment years than he had declared as income and the excess of such expenditures over income constituted taxable income to him during each taxable year. The government admitted it proved no likely source*.

This case raises important questions regarding the expenditures theory, the manner in which the government applied it in this case, and the quality and sufficiency of proof necessary

* The district judge was concerned about the government's theory in this case and at pages 759-761 questioned the prosecutor closely regarding the failure to prove a likely source. The government explained to the district court that it could prove either a likely source or negate what the prosecution called the possibility of expenditures from a prior year (760). The court thereupon made a comment which we believe constitutes the heart of this appeal, when Judge Curtin stated:

"That is true, but it is hard for me to grasp. Maybe it comes down to this: how are you going to disprove that Mr. Gay did not have these monies from beforehand? How are you going to disprove that his story was wrong? Simply because he told the agent that he had a couple of thousand dollars at the starting point?"

to be presented by the government to convict one of a felony crime based on such circumstantial evidence.

The defendant-appellant takes issue with each and every one of the logical premises upon which the government seeks to draw an inference of guilt including very basically, the premise that because one spends more money than he declares in income during a taxable period, the excess is presumed taxable income to him. Furthermore, the entire evidence in the case both presented by the defendant and stipulated to by the government, showed that the defendant had non-taxable sources of income during the indictment period and prior thereto from mortgage loans made during the preceding twenty years and thus the government's case must fail as a matter of law.

If this were not enough, the evidence in this case and specifically not only the testimony of the defendant and the members of his family, but the history of documented business dealings which the defendant had with third parties stipulated to by the government concerning cash mortgage loans, demonstrated and corroborated the existence of the cash hoard and established a reasonable doubt as a matter of law. For all of these reasons as we shall demonstrate below, there existed a reasonable doubt as to the defendant's guilt and the judgment should be reversed.

Preliminary Observations

Before embarking in a discussion of the facts and law regarding this conviction, we wish to make a few observations. The Supreme Court of the United States has cautioned regarding net worth tax prosecutions, that they require "the exercise of great care and restraint" and that "the taxpayer may be ensnared in the system which, though dif-

ficult for the prosecution is equally hard for the defendant". *Holland v. United States*, 348 U.S. at 129. The same Court has also cautioned Courts of Appeals that review of such cases should be done "bearing consistently in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only as approximation" *id.*

Because we believe that all of the caveats set forth there apply to this defendant in this case, we respectfully suggest a reading of the quoted language in *Holland* 348 US 121 at 125-9 before proceeding*.

Finally, in no area of law are the rights of defendants in criminal cases more evanescent than in the area of tax prosecutions. In this case, by applying any of the traditional standards regarding burden of proof in criminal matters which protect those charged with crimes, the guilt of the defendant in this case was not established beyond a reasonable doubt. In the face of all the evidence to the contrary, this Court should reverse this conviction.

The Facts**

Joseph J. Gay was born in Buffalo, New York in 1914 (677)***. He was one of ten children (362-368) of Polish immigrants (365) and his father spelled his name Gaj. The Gaj family was not financially well circumstanced as attested to by the fact that Joseph completed his formal education at

*This quoted language will be included in our reply brief.

**We recognize that regarding the facts, this Court is required to take the view most favorable to the government. In most instances, the facts recited are not disputed in the record. In other instances, we deem it important that the court know the circumstances of the defendant in evaluating whether or not there existed a reasonable doubt as a matter of law.

***Numbers refer to pages of Appendix.

School 69 in the City of Buffalo (677) and when he finished eighth grade took a job as a printer's apprentice (678).

After four years of learning the trade, Mr Gay purchased a small printing press and went into business for himself (678). This was during the depths of the depression in the midst of bank failures and economic strife (683). Times were hard and no less so for the defendant. Embarking in his own business during this period, instilled with traditional Polish upbringing recognizing the value of hard work and thrift, he pressed forward in his small business and in 1936 married Stella Kosowski (682) and within three years, two daughters were born (623, 609).

So it was that in 1939 Mr. Gay, engaged in a small printing business of his own operated out of his own home, was looking for an "opportunity" in order to further provide for his wife and two small daughters. Mrs. Kosowski, his wife's mother, had been in the tavern business during the 1930's and had prospered (679). One did not have to be too sophisticated to make the observation that even in the financially depressed 1930's, a neighborhood tavern was an excellent source of income. Joseph Gay came to learn that there was a tavern business for sale in Buffalo's 1st Ward* at Perry and Red Jacket Streets (679), a residential and industrial neighborhood (732-3) where the clientel would be drawn from not only those residing in the neighborhood, but also those that worked in the factories and warehouses nearby (733). Although Mr. Gay was interested in getting into the tavern business, his lack of capital prevented him from doing so and he so advised his mother-in-law (679). She agreed, however, to loan Joseph \$15,000 to purchase the business which he did.

* During this time and even to today, Buffalo's 1st Ward has traditionally been an Irish community.

This was his first experience in the necessity for having readily available capital to cash in on a business opportunity.

Joseph, his wife Stella, and his mother-in-law, who was experienced from her prior business (731), worked long hours, employed no outside help and the business did well. Its clientel was drawn from businesses nearby, workers stopping for traditional shots and beers, and a basic dinner trade resulting from the fact that they served fish fries on Friday and chicken dinners on Saturday (731). The business was so successful that in 1942 Joseph Gay was able to sell it and net \$65,000 in cash which included the original \$15,000 loaned to him by his mother-in-law which she declined when he offered to return it and told him to "hold on to it" (680-681).

Although the reason given for the sale of a successful closely held business in 1942 was because the neighborhood had started to deteriorate (732) an additional reason, not explicated by the defendant during the trial even though the trial judge made inquiry (732) was to avoid military service.

The defendant at this time was 27 years old and although he had two young daughters, was not exempt from the draft as a tavern proprietor, but by obtaining employment in local defense plants at Chevrolet and Bell Aircraft (681) he could obtain the necessary exemption to avoid military service.

For this reason, during the war years, Joseph Gay did work in defense plants, first at Chevrolet, Tonawanda (681) and thereafter, at Bell Aircraft (681). In late 1944, he began to work for the Erie Railroad because his father and his brothers all worked there and there was a shortage of switchmen (681). He continued his small printing business on the side (682), devoting 10 to 12 hours a week (746), to the printing of business cards, letterheads, envelopes, tickets (746), wedding invitations, program books for churches and remembrance

cards for local funeral parlors (629). Because he was not interested in the meager return of the banks (2%) on deposited funds and because he wanted the money available for investment purposes (682-683), he kept the \$65,000 proceeds on the sale of the tavern in cash. This is best summarized by the testimony of the defendant himself:

"I have been in the habit of keeping cash ever since the '40's. I feel safe with cash. I have always done the business, a lot of business in cash and I feel I should have it on hand whenever an opportunity arises I have it available." (708).

In 1947 Joseph Gay left his employment as a switchman for the Erie Railroad and began working as a liquor salesman for Universal Liquor in Buffalo, New York (682). This employment continued until approximately 1953 and it was during this period of time that he used the cash accumulated from the sale of the tavern business to finance private mortgages at the legal rate of interest (683)*. Whatever he saved from the private printing business, he added to the cash accumulated for investment (684).

The Defendant Purchases A Home

Another business experience in 1950 while Mr. Gay was employed as a liquor salesman, served to reinforce his conviction that keeping cash readily available for investment opportunities could result in advantageous investments. During that year and in his capacity as a liquor salesman, calling upon taverns in the Buffalo area, he met a woman named Black who owned a tavern (699). She advised him that she was the owner of approximately 9 or 10 lots on Fredro Street, a

* These mortgages were at the *legal* rate of interest rather than the rate the bank would pay on deposited funds.

modest neighborhood in the east side of Buffalo, New York (698). Because of escalating expenses on this undeveloped property, she was fearful of losing all the lots and offered Joseph Gay six of the lots measuring 45 feet by 100 feet for \$600.00 each so that she could keep the remaining real property (699). Mr. Gay, believing it to be a "terrific investment" (699) paid \$3,600.00 for the six lots, decided to divide the property into four lots of 100 feet by 60 feet (699), and at no further cost to himself, together with a man named Malik, built four houses on the lots, two of which Mr. Gay kept and two of which the builder kept (700). Thus, for an investment of \$3,600.00, Mr. Gay was able to obtain for himself a new home at 3 Fredro Street where he resides to this day (700), was able to make a \$6,000.00 profit on the sale of his old home at 193 Weimer Street (700) and was able to sell the second home built by Mr. Malik at a profit of approximately \$4,000.00 (700). Little wonder then, that these were the kind of investments that Mr. Gay looked for over the years (700). Further profits were made by Mr. Gay by purchasing property at foreclosure and selling the property to third persons and taking back a mortgage at the legal rate of interest (see 701 and following; these are mortgages not otherwise reflected in the record.)

The Mortgage Investments of the Defendant

As previously mentioned, Mr. Gay became employed as a liquor salesman for Universal Liquor in the Buffalo, New York area in 1947 and continued in this employment until 1953. In this capacity he was required to call on various liquor stores and taverns promoting the alcoholic beverages handled by the company. As is customary in such a position, it was not unusual for Mr. Gay in visiting the various taverns

and in promoting sales, to "Buy the proprietor a drink. You usually have one with him and during the course of the day. . . . you have quite a few" (684). When this began to affect his health he was advised by his physician to change his employment (684). Being a man of some means from his previous investments and having the chosen profession of printing, which he learned as a young child to fall back on, Mr. Gay then resigned his job as a liquor salesman and devoted more time to printing and investments (684). Over the years, living in modest circumstances (37), he began as a regular practice, to loan third persons cash funds and take back a mortgage on homes. This amounted to quite a few mortgages from this period forward at the legal rate of interest (684). This was a benefit to Joseph Gay, since the return was higher than bank interest and it was a benefit to the mortgagor, since he could save the search and closing costs and bank attorney's fees by financing the transaction in this fashion (685). In the succeeding years, Mr. Gay loaned a "considerable amount" and held "quite a few mortgages" (684). His brother Leonard, a long time employee of Buffalo Savings Bank (369) introduced Joseph to amortization schedules so that the amount applicable to interest and principal could be easily calculated (685). From his substantial cash accumulation he loaned his brother Leonard, the bank employee, \$15,000.00 in 1956 (371, 685). This loan was to cover the purchase of Leonard's house. Apparently, even an employee of a bank could calculate the savings and the desirability of having his mortgage held by his brother rather than an impersonal financial lending institution.

The Evidence of the Cash

It was on the occasion of this loan to his brother Leonard in 1956 (371), to purchase his home in West Seneca (371) that

Leonard visited Joseph's home and observed the cash box in which he kept funds available for investment opportunities (372). He received three packages of bills, each bound together, totalling \$5,000.00 in 50's and 100's (372) and although he did not count it, he observed in the remainder of the box a sufficient number of packages to exceed \$100,000.00. It was the defendant's habit to keep his investment cash in this fashion (685).

From these funds and from principal paybacks on mortgages previously made by Joseph Gay that he made additional mortgage loans for his friends and acquaintances as follows: Wisniewski (1956) \$9,000.00 (456) (this is in addition to the other Wisniewski loans of earlier years, see page 38); Gaj (1956) \$15,000.00 (371); Skotnicki (1958) \$3,000.00 (575); Mazur (1959) \$9,000.00 (455, 589); Mazur (1960) \$2,000.00 (455, 589); Bycina (1960) \$10,000.00 (455, 605); Toporczyk (1962) \$6,000.00 (456, 600); Tokarczyk (1963) \$3,500.00 (455, 595); Kaczmarek (1963) \$6,000.00 (455, 581); Wisniewski (1968) \$7,000.00 (456); Kocol (1969) \$5,000.00 (455); Mazurowski (1971) \$6,000.00 (456) and Wetzel (1971) no amount given (456)*.

Also during this period of time, Mr. Gay, remembering that his initial success in business was due to a \$15,000.00 interest free loan from his mother-in-law which he was not required to return (679, 681), made certain interest free loans to his daughters and to his son-in-law's father in order to assist them in business and in life. The first of these was to his daughter Lorraine, his first born, and her husband for the purchase of their home and amounted to \$13,000.00 (626)

*These mortgage loans were not disputed by the government, were documented in the Erie County Clerk's Office and were testified to during the trial in most instances by the recipient of the cash loan.

which money was handed over to them in cash in a lunch bag. Thereafter, and when his second daughter Dorothy married and she and her husband were purchasing their first home, he made an interest free loan to his daughter in the amount of \$15,000.00 in 1965. The money was in cash in Mr. Gay's home (612-613). These loans were confirmed by Joseph Gay (728). Finally, when the business in which Joseph Gay's son-in-law was engaged with his father required additional capital to purchase business property adjoining the premises, Mr. Gay agreed to and did furnish \$20,000 in cash to finance the purchase of such property (647). So it was that Mr. Gay, picking and choosing his business opportunities and keeping himself in a liquid condition to have available capital, continued in private mortgages during the 1960's and not forgetting that he had been a beneficiary of an interfamilial loan when he was a young man, aided the members of his family in a similar fashion. It was also during this time that Mr. Gay began to open savings accounts at his brother's bank when prizes were awarded for making initial deposits (373) and during the 1960's when the return on investment capital was advantageous, began to make small investments in common stock (686). These investments were made from accumulated cash savings (687). The cash savings was accumulated from prior investments as outlined above, in the tavern, and in the mortgages previously mentioned, the principal of which was paid back to Mr. Gay in cash (577, 582, 591, 596, 602, 606, 663, 695, 697). The method of cash savings was that Mr. Gay would save such cash in 50's and 100's and package them together in amounts of \$5,000.00 (685, 671). Several witnesses, other than the defendant himself, testified to observing the cash kept in a metal box (372, 651, 670), which was stored in an attic space (615, 628) in the house at 3 Fredro Street.

The Robbery

As a result of these many transactions over the years, including the cash loans, it came to be generally known that Joseph Gay had cash available for investment. As expressed one witness, "he was like me—had no education—nothing—always had a dollar" (594) and as expressed by the defendant himself "it was common knowledge that I gave out quite a few mortgages . . . in cash" (688). In 1969 there occurred an event which was to alter Mr. Gay's method of handling his finances and eventually resulted in the bringing of the indictment in this case by the United States. On December 17, 1969 the doorbell rang at Mr. Gay's home and he answered it. Three men forced their way into his home (686), physically beat Mr. Gay and demanded to know the location of the safe (688). These hoodlums even went so far as to punch holes through the wall in the basement looking for a likely place to secrete cash (651). Mr. Gay was forced to turn over to the robbers \$900.00 cash kept in his coat pocket, \$300.00 kept near the printing press (689), his wife's fur coat (689), but as he later related to his son-in-law, "they never got the big one" (651) referring to the cash kept in the metal box (651) secreted away in the attic crawl space (615, 628, 632). It was on this occasion shortly after the robbery that Mr. Gay showed his son-in-law, Mr. Russo, the box with the cash which contained twenty-two bundles of \$5,000.00 kept in 50's and 100's (671).

After the robbery, Mr. Gay was surprised to learn that not only he kept large amounts of cash in his home, but his wife kept close to \$10,000.00 in a woman's purse in her own bedroom, monies accumulated from the amounts he had given to her each week for household expenses (689). When Mr. Gay discovered this, he bought a Government Treasury

Bond with that money (689). The frightening experience of the robbery altered Mr. Gay's manner of dealing with his property. Perhaps born by the fear of losing the capital he had worked hard to accumulate over the past 30 years and perhaps from the shocking experience of being attacked by robbers in his own home, or perhaps a combination of both, convinced him that keeping large cash amounts in his home was less than prudent (690). It was then that Mr. Gay in 1970 after the robbery experience, purchased close to \$180,000.00 in Government Bonds and stocks (Gov't. Exhibit 159). These included considerable expenditures made in April of 1970 (see Gov't. Exhibits 64, 65, 67 and 68). These expenditures were accounted for by a \$138,000.00 decrease in his deposits in various Buffalo banks (see Gov't. Exhibit 141) and by a reduction in the amount of cash kept in his home, of approximately \$70,000.00. It will be recalled, as outlined above, that approximately 2 days after the robbery, Joseph Gay showed his son-in-law the cash box containing \$110,000.00 (671). In late October of 1970, after making the investments in Government bonds, and stocks and on the occasion when Mr. Gay and his wife were about to take a trip with the Clinton Businessmen's Association, prior to his departure, he again showed his son-in-law where the cash was kept and the box contained \$40,000.00 (672). Mr. Russo inquired as to what happened to the rest of it and Mr. Gay advised him that he had been investing (672). This occurred in late October of 1970 (674). There is no claim, nor could there be, that there was any effort by Mr. Gay to secretly transact this business since all of the stocks and bonds were purchased in his name or that of his wife and there was no attempt with respect to the stock or bond transactions to register the securities and the name of the nominee.

The Investigation

In this sophisticated and complex society, however, where the government takes an active interest in the business of its citizens, one does not purchase close to \$180,000.00 in securities without alerting its curiosity. In the winter of 1971, IRS agents commenced an investigation into the finances of Mr. Gay which was extensive unrelenting, and detailed. There is no claim, nor could there be that he did not cooperate with them in this investigation. He voluntarily turned over to them, all of his books and records and attempted as best he could with the benefit of his minimal formal education to explain to them the manner in which he had conducted business over the past three decades. The government investigation and the indictment subsequently returned by the Grand Jury, however, took a strange turn. Although charging the defendant with tax fraud for the years 1967-1971, the government did not proceed on a net worth theory of prosecution*. The reason for this is plain. If the government chose to proceed on a net worth basis it would be required to credit the defendant Joseph Gay with all the outstanding mortgages which he had at the beginning of the in-

* In *Taglianetti v. United States*, 398 F.2d 558 (1st Cir. 1968) the leading case approving the "cash expenditure" theory, the First Circuit compared the cash expenditure theory with the net worth theory and stated:

"The net worth method involves the ascertaining of a taxpayer's net worth positions at the beginning and end of a tax period, and deriving that part of any increase not attributable to reported income. This method, while effective against taxpayers who channel their income into investment or durable property, is unavailing against the taxpayer who consumes his self-determined tax free dollars during the year and winds up no wealthier than before. The cash expenditure method is devised to reach such a taxpayer . . ." 398 F.2d at 562.

Thus, the reason given as justification for the "expenditure" theory does not apply to this defendant since it is undisputed that his expenditures were made for investment in stocks and bonds.

dictment period, as his beginning net worth. If it had done this, the defendant's beginning net worth would account for the changes during the indictment years, since the value of his mortgages would account for the changes from mortgage loans to stocks and bonds during the indictment period in question. Instead, the government chose to impale Mr. Gay on a dilemma, by attempting to elicit from him in *six* separate unsworn interviews (see Supplemental Appendix pp. 929-948), the fact that he had not accumulated cash prior to the first indictment year. Mr. Gay, quite understandably, was reluctant to advise the government agents of his practice of accumulating cash. After the robbery experience of December 1969, this is quite understandable. Likewise, when the government inquired about interest bearing mortgages, he did not disclose to them the interest free mortgages and loans he had made to members of his family on the grounds that it was none of their business and moreover, they were interested in income rather than return of principal. When asked concerning "cash on hand", the defendant advised the government agents that he sometimes had \$2,000.00 in his pocket, but did not advise them of the money which he kept in his attic crawl space. The government then, on trial of the case, credited the defendant with \$2,000.00 cash on hand for each one of the indictment years and deducted \$2,000.00 cash on hand at the end of each indictment year, a meaningless accounting entry (see Gov't. Exhibit 141 reproduced at page 910).

The defendant at trial, did not dispute the expenditures as detailed by the government evidence (747). What the defendant does dispute, is the proof of the government which failed to establish with reasonable certainty, the extent to which beginning resources contributed to the expenditures in

the indictment years as required by *United States v. Bianco*, 534 F.2d 501 at 504 (2d Cir. 1976). The defendant further disputes the meaningless accounting entry of the \$2,000.00 cash on hand figure for each of the indictment years. The evidence presented by both the government and the defendant established that for many, many years prior to the indictment period, the defendant had made cash loans to various persons. This was not disputed by the Government (455). Indeed, the government *stipulated* that these mortgages had been made. The defendant furnished the government proof by giving the name of the mortgagor and the amount of the loan and the interest which was paid during the years about which the government made inquiry (77-78). The defendant also introduced into evidence (Defense Exhibits 1 through 16) his savings bank passbooks. These passbooks covered the period from 1954, through and including the time of trial (733-734). The government *stipulated* as to the amount of mortgage loans made during this period as reflected by the records kept in the Erie County Clerk's Office (455) and as related by the defendant to the government investigating authorities. These documents show that the cash loans of the defendant to the mortgagors in question did not come from the monies kept in the savings banks during this period. In other words, there is no corresponding decrease in the savings bank passbook with the amount of the cash loan as evidenced by the mortgage or as testified to by those persons to whom the loan was made. Thus, the evidence disclosed the existence of cash available for the defendant's use prior to the indictment period and negated the inference that the expenditures which were made between 1967 and 1971, came from currently taxable income. It should also be remembered that the government nowhere during the trial, established a "likely source" of income for the defendant during the period. We therefore come down to the fact that the govern-

ment sought to create a factual question for the jury by the defendant's statement to the Internal Revenue Agents that he had \$2,000.00 "cash on hand". Other evidence, introduced by both the government and the defendant, however, showed that for a period of years dating back to the 40's and 50's, the defendant made cash loans to various individuals. This was evidenced by the government's stipulation into evidence of the mortgage loans on file in the Erie County Clerk's Office, the testimony of the various persons who had received the money, the testimony of the defendant and the testimony of the members of the defendant's family, including his daughters and son-in-law. It is undisputed that at no time was the defendant questioned as to whether or not he had accumulated large amounts of cash from which he made investments and secreted it in his home or elsewhere during the years prior to the indictment period. The only question that was asked of him was the inquiry concerning "cash on hand".

The Government's Case

The government presented extensive evidence of the expenditures made by the defendant during the indictment years including his purchases of government bonds and stock of \$180,000 in 1970 and various other stock and bond purchases between 1967 and 1971. According to the government, this proof that his expenditures exceeded the sources which he had available showed an excess of expenditures from funds available of a total of \$167,000 for the five year period which the government, after deducting the taxable income reported by the defendant, claimed was taxable income. These figures were summarized on a chart which is set forth in the appendix at page 911 and marked Government Exhibit 159. Each of the jurors was given a copy of this exhibit and, in addition, a

pretentious and impressive looking chart containing the same figures, measuring in excess of 25 square feet was displayed to the jury. The figures which wound their way into Government Exhibit 159 depended to a large degree on the accuracy of Government Exhibit 141, which is reproduced in the appendix at page 910. This purported to be an analysis of bank balances and cash on hand. In listing cash on hand, the government added \$2,000 and subtracted \$2,000 at the beginning and end of each taxable year. Its justification for this was the statement of the defendant extracted from him after a number of interviews that his cash on hand totaled about \$2,000. This statement was nowhere corroborated by any other evidence and the testimony at the trial was cumulative and extensive to the contrary. Not only the defendant testified concerning his extensive cash accumulation, but the defendant's son-in-law, and his two daughters corroborated his statement, in addition to his brother, who was a government witness. Moreover, extensive documentation was stipulated to by the government concerning cash mortgage loans made by the defendant, live testimony of witnesses who had received the cash amounts from Mr. Gay was also on the record and the defendant introduced as evidence copies of his many savings bank books, which showed no corresponding deduction or withdrawal at or about the time the cash mortgage loans were made by the defendant. Thus, the evidence was extensive that the defendant Joseph Gay had during the indictment years extensive cash accumulations had made considerable cash mortgage loans over the preceding 20 years. This belied the cavalier meaningless accounting entry regarding cash on hand. Because Mr. Gay in some of his bank dealings had promptly reinvested bank savings deposits in attractive interest bearing accounts years later, the government argued on summation that this was not a pattern of conduct of

a man who keeps large cash accumulations. The jury, perhaps aggrieved by the fact that the defendant had admittedly been less than candid during one of his many interviews with the Internal Revenue agents regarding cash on hand, or perhaps motivated by some envy of a man who had accumulated over his lifetime, extensive cash with only the benefit of an eighth grade education, returned a verdict of guilty on each count.

ARGUMENT

POINT I

The Government Did Not Establish Opening Net Worth With Reasonable Certainty.

The government here was required in order to meet its burden of proof under the expenditures theory to establish net worth with reasonable certainty. It failed to do so by (a) failing to prove the extent of any contribution which beginning resources or a diminution of resources over time could have made to expenditures; (b) failing to prove that the expenditures were attributable to currently taxable income and (c) by failing to follow up the leads furnished by the taxpayer regarding principal paybacks on mortgage loans made prior to the indictment years.*

(a) The failure to prove with reasonable certainty the extent of any contribution which beginning resources could have made to expenditures.

In this case, the government proceeded under a theory of proof which is called the "Cash Expenditure" method of proof. This method is "a variant of the 'net worth' method" *United States v. Bianco*, 534 F.2d 501 (2d Cir. 1976). In

* Although we attempt to treat these omissions of necessary proof separately, one necessarily spills over to another and in combination result in a failure to establish opening net worth with reasonable certainty.

Holland v. United States, 348 U.S. 121 (1954) the Supreme Court stated that the showing of an opening net worth is "an essential condition" in a net worth case. 348 U.S. at 132. The defendant does not contend that it is a requirement in a cash expenditure case to prove a formal opening net worth statement. What is required, is that the government must establish with reasonable certainty in a cash expenditure case, the extent of any contribution which beginning resources or a diminution of resources over time could have made to expenditures. *Taglianetti v. United States*, 398 F.2d 558 (1st Cir. 1968) affd. 394 U.S. 316 (1969); *United States v. Bianco*, 534 F.2d 501 at 504 (2d Cir. 1976). This must be done with "reasonable certainty", *United States v. Bianco*, *supra*. In *Bianco* the case involved a cash expenditure theory. The charge against the defendant was wilfully failing to file income tax returns. Thus, the government was required to prove only that the defendant Bianco had \$600.00 in taxable income during the years in question under 26 U.S.C. § 7203. This Court discussed the requirement that the government establish with "reasonable certainty" proof showing "the extent of any contribution which beginning resources or a diminution of resources over time could have made to expenditures", quoting from *Taglianetti v. United States*, 398 F. 2d at 565. Significantly, this Court said:

"Nevertheless, the government *properly concedes* in the present case that the 'reasonable certainty' standard applies in cash expenditure cases . . .". *United States v. Bianco*, 534 F. 2d 504 (2d Cir. 1976).

In *Bianco*, this Court found that the government's proof was sufficient since the government showed that the defendant Bianco had no beginning resources which could have contributed to his expenditures during the tax years. This is the proof which the government failed to introduce in this case.

The testimony of the government agents and the leads furnished by the defendant established that prior to the indictment years the defendant had made considerable cash mortgage loans to persons which were paid back during the years prior to the indictment (see the testimony of Krystoff, 63-64 and exhibits 75-83 showing the amounts of the mortgages, the names of the people to whom the loans were made and the years in which they were made*). While it is true that the government credited the defendant with sources of funds during the prosecution years of principal paybacks on mortgages which were received by him during the indictment years, the government did *not* credit the defendant with amounts paid back to him during the years prior to the indictment which were beginning resources which over the time accounted for expenditures. The only way this can be explained, is if it is *assumed* that the defendant, Gay deposited the principal mortgage repayments in years prior to those set forth in the indictment in his bank accounts. This was a ~~false~~ assumption on the part of the government and demonstrates that there existed a reasonable doubt as to whether or not the expenditures made during the indictment years were expenditures from non-taxable sources of income. The amounts of the mortgage loans and the names of the persons to whom such loans were made are set forth in the transcript at pages 455 and 456 inclusive. Additionally, on behalf of the defendant there was introduced evidence to show other mortgage loans which were made prior to the indictment years to members of his family and others (575-676).

The court, during the trial, was aware of the failure of the government to meet the "reasonable certainty" requirement under the cash expenditure cases when it commented:

"The expenditure system just seems to be a very sloppy way of proving a net worth." (758).

* See chart page 38.

Because the bank accounts of the defendant Gay, which were at all times available to the government and which were introduced into evidence (see defendant's Exhibits 1-15) showed that there was no withdrawal from the bank accounts at any time when these prior loans were made as set forth in the transcript and which leads were given to the government, the court recognized the impropriety of the government assumption that the amounts were redeposited by saying "therefore it must have been from a cash hoard because there are no withdrawals from any banks of large sums of money at or about the time the mortgage loan was made." (765). In addition, close scrutiny of the defendant's exhibits of the bank accounts show that the government is unable to trace the principal mortgage paybacks prior to the indictment years into the bank accounts.

In *Marcus v. United States*, 422 F. 2d 752, 755 (5th Cir. 1970), an expenditures prosecution, the 5th Circuit Court of Appeals reversed the conviction of the defendant for the very reason that we raise here. There the 5th Circuit stated:

"The government failed to lay any foundation to indicate that the expenditures came out of current income, and, for this reason, the jury could not infer that Marcus had a gross income in excess of \$600.00 out of which the expenditures had been made, and further, that, by making the expenditures, he had to know that he had a gross income in excess of \$600.00. As was said in *Dupree v. United States*, 5 Cir., 1955, 218 F. 2d 781, 784: "If there is no established figure showing the source from which the expenditures during the year can be made, or the complete lack of such source, then there is no relevance to proof of expenditures during the year, no matter how large they may be." See *Blumberg v. United States*, 5 Cir., 1955, 222 F. 2d 496, 499-500; *Bryan v. United States*, 5 Cir., 1949, 175 F. 2d 223."

The failure of the government to establish with reasonable certainty and credit the defendant to the extent any contribution which beginning resources or a diminution of resources over time could have made to expenditures, as required by this Court in *United States v. Bianco*, 534 F. 2d 501 at 504 (2d Cir. 1976) was a fatal omission of necessary proof and requires reversal standing by itself.

(b) The failure to prove that the expenditures were attributable to currently taxable income.

On this point we start off with the proposition with which we are sure the court will agree, that if the defendant in years prior to the indictment years had taxable income from any source whatsoever which he failed to report and which accounted for the expenditures during the indictment years, that would be a basis insufficient in law to sustain convictions for the years in question. This proposition, however correct in law it may be, is not one which particularly appeals to jurors who have presumably paid their fair share of taxes on the taxable incomes that they have earned over the years. It is precisely because this point of law could be lost by the jurors in the jury room that we urge this Court to review the proofs in this case, including the positions taken by the government with respect to matters, things and evidence which the court later ruled inadmissible, to show that that is precisely what happened in this case and for that reason the conviction should be reversed.

An essential element of the proof the government was required to present in this tax fraud case, was that the defendant received undeclared taxable income during the years in question. The cases on the subject are uniform in holding that expenditures in excess of reported income standing alone, is

not sufficient to support a conviction, *United States v. Johnson*, 319 U.S. 503 (1943); *United States v. Nunan*, 236 F.2d 576 (2d Cir. 1956); *Stinnett v. United States*, 173 F.2d 129 (4th Cir. 1949) and *Gleckman v. United States*, 80 F.2d 394 (8th Cir. 1935).

In *United States v. Uccellini*, 159 F.Supp. 491 (W.D.P.A. 1957) the district court granted the defendant's motion for judgment of acquittal after a jury verdict of guilty and said in part:

"The inference that excess expenditures are attributable to currently taxable income must be supported by evidence. Expenditures in excess of reported income standing alone are not sufficient to support a conviction."

In this case during the presentation of the government's proof, an attempt was made to introduce before the jury, what is commonly referred to as a "likely source". It was the position of the government that the defendant, in years past, had been engaged in a bookmaking operation. The government presented its evidence in the absence of the jury (398 to 443). The court ruled that the proof offered by the government was "too prejudicial" and among other things "not fair to the defendant" (442-443) and refused to allow the government to present this evidence of a "likely source". Although the government presented evidence that the defendant was engaged in a minor printing business during the years in question (739), there was evidence that this printing business was a very minimal operation (629-679) and that the defendant printed funeral cards, wedding invitations in the basement (679) of his home (616-617, 629). The government at all times had available to it, the complete records of the printing business (65) and after a complete investigation, the

government agent concluded that there was no proof that the defendant had received undeclared amounts of income from the printing business (see Court Exhibit 27, Supplemental Appendix pp. 949 to 980 particularly p. 965 wherein the agent states:

"An examination of the above books and records by Revenue Agent, Eugene F. Chruma disclosed that the receipts from JOSEPH GAY'S printing business (Exhibit 27, photocopy of receipt's book) agree substantially with the amount of gross receipts as shown on the individual income tax returns for each of the years 1967 through 1971."

The government did not claim at this time, nor could it, that the printing business was a "likely source" of income. The court was troubled by this state of affairs and expressed its concern as follows:

"In the evidence there is nothing else to show where these monies came from. Don't you have to show the jury that arguably he had some other means of getting money?"

The prosecutor replied "No you don't your honor."

" . . . You either have to show a likely source of the income . . . or negative the fact that all these expenditures came from a prior year, and once you negative the possibility of the expenditures from a prior year, then there is no likely source required." (p. 760.)*

The fact is that the government not only failed to show a "likely source", but also failed to negate expenditures from prior years. The question of whether or not the government

* It is quite clear that at this point the government did not claim, nor could it claim, that the printing business was a "likely source", but see government's summation, page 772, wherein the prosecutor advised the jury "you could speculate that this income came from the printing business." This was clearly error and severely prejudicial to the defendant. See Point IV *infra*.

had presented sufficient proof to negate expenditures from prior year's incomes, was initially a question of law. The stark fact is, that the proof presented by the government showed non-taxable income in prior years from the mortgages detailed under Point I above. These mortgage loans were all made in cash. No corresponding withdrawals were made from the bank accounts during the years in question, dating back from 1956 through 1966. The complete fallacy of the government's position is clearly pointed out by the following testimony:

"Q. What I am trying to ask you, sir, is in your report does it, anywhere, reflect Mr. Quinn's statement that there was some sixty-nine thousand odd dollars earned between 45 and the end of 1971?

A. That is prior earnings to 1967 if I remember correctly.

Q. Right.

A. Earnings and whatever, so when you say taken into account, this would have to be monies back to 1943. You are talking twenty, twenty-three years.

Q. You didn't—.

A. Prior.

Q. All right go ahead.

A. How can I take that into account?

Q. That is all I want you to testify to. If you did not do it then say you didn't do it.

A. They are prior earnings. I don't understand how you take them into account. They are either spent in the form of investments or cost of living.

Q. Or saved?

A. Or saved, which would show up in the bank accounts.

Q. Pardon?

A. Which would show up in the savings accounts."

(557-558).

It becomes immediately apparent that it is the position of the government that the monies earned by the defendant in

prior years and received by the defendant as disclosed in the leads furnished to the government, from principal mortgage paybacks during the years 1956 through 1966, were accounted for because they "would show up in the savings accounts" (558). It is this critical fact which demonstrates that the government failed to negate nontaxable sources from prior years by *assuming* that such monies if saved would show up in the savings accounts. We know of no rule of law, custom, equity or procedure which requires a citizen to save his money in savings accounts rather than in cash. We are sure the banks would lobby intensively for such a statute. Perhaps, IRS agents always save their money in savings accounts. The evidence discloses, however, Mr. Gay, the defendant, chose to do otherwise. This is not a crime. The government did not trace any of the principal mortgage paybacks into the savings accounts, nor could it establish such a tracing. The fact remains that on the entire record the defendant received in preindictment years, money which was nontaxable and which accounted for the expenditures during the indictment years. The government failed to establish either a "likely source" or to negate expenditures from prior years. Having failed to do so, it did not present a *prima facie* case and the defendant's motion for judgment of acquittal should be granted.

Other cases in which district courts have granted judgments of acquittal after jury verdicts of guilty, are particularly instructive. In *United States v. O'Mally*, 131 F.Supp. 409, 414 (E.D.Pa. 1955) the court granted the motion and stated:

"The defendant may well have over a period of years substantially increased his net worth and on a basis which may have involved understatement of taxable income. However, in a criminal prosecution for income tax evasion in a particular calendar year, the government is not permitted to allocate summarily such unaccounted

for accretions to a particular year without meeting the requirements laid down in the Holland and Adonis decisions. The government has, in the opinion of the Court, failed to meet such requirements in the instant prosecution."

In *United States v. Donovan*, 142 F. Supp. 703 at 707 (E.D. Va. 1956) the court granted the motion for judgment of acquittal and stated:

"To sustain the verdict in this case would establish a principle to the effect that a showing by the government of an increase in the known value of the net worth of the assets of the taxpayer, alone, is sufficient to place upon him the burden of proving that none of it represents unreported currently taxable income. This the courts have declined to do. To follow such a course to a logical conclusion would lead to a situation in which a showing that the taxpayer had spent more than he reported as income in a given period would place upon him the burden of proving that the excess was not taxable income."

In *United States v. Uccellini*, 159 F. Supp. 491 at 496 (W.D. Pa. 1957) the court in granting a judgment of acquittal stated:

"But when that case is destroyed by the impact of its own evidence, i.e., that defendant had cash available sufficient to cover expenditures and excessive income, which cash was not derived from his known sources of current taxable income, it cannot shift the burden of proof to the defendant under the Supreme Court's protective rule."

The court also stated in that case in a supplemental opinion (159 F. Supp. 496) that:

". . . the facts established by the government itself destroyed the inferences normally to be drawn from the indirect methods of proof used in this case."

This is particularly appropriate in this case because the government's own evidence showed the principal mortgage

loans and paybacks to the defendant during the years prior to the indictment (see 455-456). It was these sums that the government failed to account for in attempting to negate nontaxable sources.

In *United States v. Klineman*, 167 F.Supp. 870 (C.D. Cal. 1958) the court stated:

"It is firmly established that increases in income, standing alone, cannot be assumed to be attributable to taxable income; that there must be some evidence to support such an inference. . . . That is, there must be a basis for concluding that unreported income was realized in the year for which the prosecution was based and was not acquired in any earlier year . . . (citations omitted)."

The government failed to prove a "likely source". The evidence discloses that not only the government failed to negate nontaxable sources, but indeed *presented evidence* of nontaxable sources in years prior to the prosecution. Having done this it failed to establish a *prima facie* case and the defendant's motion for judgment of acquittal should be granted.

(c) The failure of the government to follow up leads furnished by the taxpayer.

We have previously quoted from *Holland v. United States*, *supra* the requirement as laid down by the Supreme Court of the United States, that the government investigate leads furnished to them by the defendant. This is one of the safeguards which the court has required in cases such as this which are, to use the Court's words "so fraught with danger for the innocent" 348 U.S. 125. In this case, the defendant furnished to the government investigator all of his savings bank accounts (Transcript 131 *et seq.*) and also certain mortgage records

which involve transactions in years prior to the indictment years (75 and following). He provided the government with the mortgage material on January 6, 1972 (61, 76). The government credited the defendant with principal mortgage paybacks to him during the years in question (see government Exhibit 159 "principal payments received on mortgages"). What the government *failed* to do, however, was to credit the defendant with principal mortgage paybacks in the 50's and 60's prior to the indictment years which evidence had been furnished to the government by the defendant on January 6, 1972 (See 76 and 455 and 456). It failed to credit the defendant with these principal mortgage paybacks because it *assumed* that the money received by the defendant from the mortgagees "would show up on the bank accounts" (557). The government did not trace the principal paybacks into the bank accounts which had been furnished to the government. We quote from the transcript to show unequivocally that the government did not follow up these leads furnished by the defendant:

"Q. All right. There was evidence in this case, was there not, at the time that you made out your report, all of the banks books submitted into evidence, is that right?

A. That's correct.

Q. All right. You didn't utilize these at all?

A. No, I did not. I worked from the bank statements as submitted by the various banks.

Q. And they began as of when?

A. I don't recall but they go beyond, they go prior to 1966.

Q. The books go prior or the bank statements go prior?

A. I think the bank statements go back. I would have to look at the statements to be sure but I didn't concern myself to much with prior." (558).

“ . . .
 Q. So you can't then state from anything that is in the evidence in this case that all of the savings that Mr. Gay would have had were in the bank prior to the year 1966?

A. No I cannot.” (559).

Another government agent also testified as follows:

“Q. All right. In any event, you went down there and he showed you some hand written sheets. Did he not with regard to the mortgages, the amount of the mortgage and the payment date, isn't that right?

A. Yes sir.

Q. These were sheets made up by himself, is that true?

A. Yes, sir.

Q. In handwriting, his own handwriting?

A. That's correct.

Q. All right. Let me ask you, did you ever go to check whether any of these mortgages were ever recorded in the County Clerk's Office?

A. Yes, I did.

Q. When?

A. Some time,—some time during the investigation, most likely afterwards.

Q. Well, I don't want, 'most likely'. When did you do it?

A. I don't recall when I checked.” (77-78).

And testified further:

“Q. All right. Now, following,—when you saw these mortgages, did you look at the actual mortgage itself?

A. On file at the County Clerk?

Q. Yes.

A. Yes I did.

Q. Or did you just look into the book to see that the mortgage was recorded?

A. No. I looked at the actual mortgage.

. . . .

Q. Well, did you make any notes, any memorandum with regard to what you saw in the Erie County Clerk's Office?

A. No I did not.

Q. Now, did you ever, during the course of your investigation, run down any mortgages that had been paid in full previously?

A. I do not believe so.

Q. Did you ever ask Mr. Gay whether or not he had mortgages previous to this particular date which you have identified, that had been paid up, say a month before your investigation began?

A. I do not recall asking that question.

Q. Now, you would, of course be concerned with that would you not?

A. Yes, I would be.

Q. All right. You would want to know during the course of your investigation how much the man had invested over the years, isn't that true?

A. Yes.

Q. Because what you were looking for was cash that could not be accounted for, isn't that right?

A. Yes.

Q. And which you would then term income to show an evasion, isn't that right?

A. At that point, not necessarily so.

Q. All right. In any event, you didn't bother to check how much he had invested previous to these particular existing mortgages?

A. That's correct.

Q. Now, did you, at any time interview any of these individuals who had outstanding mortgages with Mr. Gay, with regard to how the money had been transferred to them, how the mortgage came about?

A. No, I did not.

Q. Not at all?

A. No, sir." (78-80).

Finally, the investigator for the government testified:

"Q. I am sorry, sir. Did you, during the course of your investigation, learn that the Bycina mortgage \$10,000.00 in cash was delivered to Mr. Bycina?

A. No, I did not.

Q. All right. Did you learn, through your investigation on any of these mortgages, that cash was transferred to the individual.

A. No, I did not." (85).

We are here referring to the mortgages which were disclosed to the government investigators and were mortgages given in years prior to the indictment years and paid back in years prior to the indictment years. For a listing of these mortgages, see transcript pages 455 and 456. See also government exhibits 75, 76, 77, 78, 83 and 81. The names of the mortgagors were Shotnicki, Toporczyk, Mazur, Bycina, Kaczarack and Wysnewski.

The failure of the government to credit the defendant with the principal mortgage payments which were made to him in the years prior to January 1, 1967* was a failure to follow leads furnished to the government by the defendant and requires judgment of acquittal under *Holland v. United States, supra*.

Further evidence that the government did not trace leads furnished to them by the defendant is found in Government Exhibit 2 for identification (Tax return of defendant for 1965 and Government Exhibit 3 for identification, tax return of defendant for 1966). These tax returns show mortgage interest income of \$1,869.08 for the calendar year 1965 and mortgage interest income of \$6,837.03 for 1966. The tax returns, of

* See summary at page 38.

course, do not indicate the amount of principal paid back on these mortgages since such an item would not constitute taxable income. These returns list by name the names of the mortgagors as follows: Wisniewski, Tokarczyk, Mazur, Wyczalek, Kaczmarek, Bycina and Toporczyk. It is the failure of the government to credit the defendant Gay with the principal paybacks on these mortgages during years prior to the indictment that constitutes the government's failure to investigate leads as a matter of law and requires reversal.

POINT II

The "admission" of the taxpayer regarding "cash on hand" was uncorroborated.

One of the lynch pins upon which the government proof rested, was the position of the government, that in the beginning of the first prosecution year the defendant had only \$2,000.00 cash on hand which figure remained constant throughout the indictment. (See Government Exhibit 141 at p. 910). The testimony of the government agent was that during the fourth of 6 separate interviews with the defendant, the defendant stated in response to an inquiry concerning cash on hand, that it was about "\$2,000.00" (Interview June 8, 1972); other interviews of the defendant were conducted by government agents on December 28, 1971, January 6, 1972, January 11, 1972, February 21, 1973 and May 8, 1973. In the first place, this statement of the defendant in no way related to a response to an inquiry concerning whether or not cash or a cash hoard prior to January 1, 1967 was in any way responsible for the expenditures made between January 1, 1967 and December 31, 1971. This was the inquiry which the government was required to make in attempting to negate the existence of cash as an available asset with which to make the expenditures detailed by the government proof.

What the government did with this so-called "admission" was to credit the defendant with \$2,000.00 cash on hand for each of the prosecution years. This amounted to a meaningless accounting entry and in no way was even this figure credited as an available source of funds for the expenditures during the indictment years! Assuming the defendant would have the hardihood to advise the agents in a Buffalo tavern (719-21) of the existence of a \$110,000.00 cash hoard which was responsible for his expenditures during the indictment years, the treatment by the government of making such a cash on hand entry for each of the indictment years as they did on government exhibit 141, would have availed the defendant of nothing since in each year the government simply added the amount and subtracted the amount in arriving at the total net increase or decrease in bank balances and cash on hand.

But more than this, it is the position of the defendant that the so-called admission was not corroborated by independent evidence in the case as required under *United States v. Calderon*, 348 U.S. 160 at 169 (1954) where the United States Supreme Court stated:

"As we said, the circumstances surrounding respondent's admissions create considerable doubt as to their reliability. We have therefore examined the independent evidence with great care to insure that the accused will not be convicted on the basis of a false admission alone."

We note in the first instance that none of the six interviews conducted by the government agents was an interview of the defendant while he was under oath. No Q. and A. of the defendant was ever taken. As stated in *Holland v. United States*:

"When a revenue agent confronts the taxpayer with an apparent deficiency, the latter may be more concerned with a quick settlement than an honest search for the truth." 348 U.S. 121, 128.

Moreover, Internal Revenue Agent Russo, who testified as the government expert in this case used various definitions of the term "cash on hand". He first defined it as cash "on hand at the year end, not during the course of the year" (541). Thereafter he testified it is cash "available at any time" (551). He then testified that if the defendant gave a \$6,000.00 cash mortgage during the year "that is not cash on hand" (553-554).

There is no testimony that the defendant was aware of this accounting view, or Internal Revenue view, or Mr. Russo's changing view, of what was encompassed by the technical term "cash on hand". The government used the claimed \$2,000.00 "admission" as proof that the defendant had no cash accumulation *at any time* to account for expenditures. There is no evidence that the Internal Revenue agents ever asked the defendant if he at any time had a cash accumulation from which he made expenditures during the prosecution years. This is the inquiry that was required to be made and required to negate non-taxable sources.

The only other evidence which the government could point to as corroborative, is the discrepancies between expenditures and sources. Such, however, is not corroborative of the fact that the defendant did not have an available cash hoard on January 1, 1966 to account for the expenditures during the five year period encompassed by this indictment. This is so, because the total amounts of expenditures over funds assumes the \$2,000.00 figure as being accurate and moreover, defendant was not even credited with the \$2,000.00 expenditure during the five year period accounting in part for the excess. On this question, *Massei v. United States*, 241 F. 2d 895 at 904 (1st Cir. 1957) is in point. There the court stated in reversing the conviction:

"Evidence of unexplained net worth increased does not either bolster the admissions of likely source or establish this element of the crime independent of the admission . . ."

Courts are required, when this type of evidence is sought to be used against a defendant, to take great pains to see that the jury does not convict the defendant of being less than candid with the Internal Revenue Agents.* That is exactly and precisely what happened in this case.

The other evidence in the case including the government detailing the cash mortgage loans of the defendant during the years prior to the indictment which manifestly did not come from the bank accounts of the defendant (see defendant's exhibits 1 through 15) establish beyond cavail that there must have been a cash hoard during that period to account for the mortgage loans. Moreover, the fact that the government failed to trace the principal mortgage paybacks during the years prior to the indictment years into the savings accounts of the defendant, showed that a cash hoard existed. Finally, the evidence presented in the defendant's own behalf, including the many mortgagors that were called who testified and including the members of the family that testified to large cash loan transactions prior to the indictment years, established that the cash hoard existed and was uncorroborative of any \$2,000.00 limitation sought to be proved by the government.

The evidence in fact showed that the defendant's prior mortgage loans exceeded \$129,500.00 to be paid back to the defendant during in large part, the preindictment years which constitute nontaxable income during that period and which

* *Holland v. United States*, 348 U.S. at 128 (1954); *United States v. Caleron*, 348 U.S. at 169 (1954).

was not traced to his bank accounts.* Additionally, there was testimony of the defendant, his daughters, brother and son-in-law concerning a large cash hoard in existence prior to the indictment years totalling at one time \$110,000.00 (372, 651, 671). Thus, the evidence presented on behalf of the defendant and presented by the government, showed an amount exceeding \$239,500.00 of nontaxable funds which accounted for the excess expenditures during the entire prosecution period approximating \$170,000.00 (Government exhibit 159).

* We summarize this total with the names of the mortgagors, the year, the mortgage amount and the transcript page reference as follows:

Bycina	(1960)	\$ 10,000.00	(Tr. pp. 455, 605)
Kaczmarek	(1963)	6,000.00	(Tr. pp. 455, 581)
Korol	(1969)	5,000.00	(Tr. p. 455)
Mazur	(1960)	2,000.00	(Tr. pp. 455, 589)
Mazur	(1959)	9,000.00	(Tr. pp. 455, 589)
Topkarczyk	(1963)	3,500.00	(Tr. pp. 455, 595)
Toporczyk	(1962)	6,000.00	(Tr. pp. 456, 600)
Wisniewski	(1968)	7,000.00	(Tr. p. 456)
Wisniewski	(1956)	9,000.00	(Tr. p. 456)
Mazurowski	(1971)	6,000.00	(Tr. p. 456)
Wetzel	(1971)	No amount given	(Tr. p. 456)
Skotnicki	(1958)	3,000.00	(Tr. p. 575)
Hobart	(1965)	15,000.00	(Tr. p. 612)
Russo	(1962)	13,000.00	(Tr. pp. 626, 643)
Russo	(1967)	20,000.00	(Tr. p. 647)
Gaj	(1966)	15,000.00	(Tr. p. 371)
		<u>\$129,500.00</u>	

See transcript pages 361-364 to show that the government did not credit defendant with principal pay backs. The total of mortgage loans made prior to indictment years is \$91,500.00.

POINT III

All The Evidence In The Case Established A Reasonable Doubt As A Matter Of Law Which Requires Reversal.

At the close of the government's case (562) and at the close of all the testimony (749), and in a post verdict motion, the defendant moved for judgment of acquittal. Because the district court judge was troubled by what he referred to as "the sloppy" manner of proof, the failure to prove a likely source, and perhaps because of the overwhelming independent testimony and facts *stipulated* to by the government which showed the existence of a cash source sufficient to account for the expenditures during the indictment years, the court requested extensive briefing on the motion before denying it in his memorandum decision dated May 5, 1977 and reproduced in our Appendix at pages 912-926.

We note that in denying the motion Judge Curtin stated "The government has sufficiently met its burden of proving likely source of income." (Appendix at p. 925). This is not so, was never claimed to be so by the prosecution and we expect that in its brief the government will concede that no likely source of income was shown in this case.

What we are urging here under this point can be stated in a number of different ways: the government did not present sufficient evidence to establish guilt beyond a reasonable doubt; that on all the evidence presented a reasonable man would have a reasonable doubt or in terms of procedure, it was error for the court not to grant the defendant's many motions for judgment of acquittal.

The standard to be applied under this point is the same standard as faced the trial court under Rule 29 of the Rules of

Criminal Procedure, as set forth by this Court in the *United States v. Taylor*, 464 F.2d 240 at 242-243 (2nd Cir. 1972). The test is higher than that applied in a civil case and it is higher than a test of "clear and convincing evidence". See *United States v. Koenig*, 388 F.Supp. 670 at 682. In *Taylor* this court stated:

" 'The true rule, therefore, is that a trial judge, in passing upon a motion for directed verdict of acquittal, must determine whether upon the evidence giving full play to the right of the jury to determine credibility, weigh the evidence, and draw justifiable inferences of fact, a reasonable mind might fairly conclude guilt beyond a reasonable doubt. If he concludes that upon the evidence there must be such a doubt in a reasonable mind, he must grant the motion; or, to state it another way, if there is no evidence upon which a reasonable mind might fairly conclude guilt beyond a reasonable doubt, the motion must be granted. If he concludes that either of the two results, a reasonable doubt or no reasonable doubt is fairly possible he must let the jury decide the matter.' *Curley v. United States*, 81 U.S. App. D.C. 389, 160 F.2d 229, 232-233, cert. denied, 331 U.S. 837, 67 S.Ct. 1511, 91 L.Ed. 1850 (1947), cited in *United States v. Taylor*, *supra*, 464 F.2d at 243."

This standard is applicable to trials conducted before the court as well as trial by jury. See *United States v. Freeman*, 498 F.2d 569 (2d Cir. 1974).

It is the position of the defendant that the evidence introduced by the government and by the defendant including the stipulated mortgage loans in prior indictment years (455), the fact no withdrawals were made from the savings accounts during those years to account for the cash transactions between Mr. Gay and the mortgagors (Defendant's Exhibits 1-16), the testimony of the defendant, the testimony of the

members of the defendant's family, and the testimony of disinterested persons who received the loans (Skotnicki 575, Kaczmarek 579, Mazur 587, Tokarczyk 595, Toporczyk 600, Bycina 604) that there exists a reasonable doubt as to whether or not the expenditures were from current income. The meaningless admission of the defendant that he had \$2,000.00 cash on hand coming from a man whose formal education did not exceed the eighth grade and coming on an inquiry that did not specifically ask him to disclose the extent cash contributed to investment during the indictment period, does not create such a question of fact in a reasonable mind which could be resolved without doubt.

We have previously referred to the extensive evidence, both documentary and testimonial, that established the cash fund from which the defendant made mortgage loans prior to and during the indictment years. It is the position of the defendant that all of this evidence coupled with the fact that there were no corresponding decreases in bank accounts from which these loans could have been made established a reasonable doubt as a matter of law concerning the cash accumulations which would explain a nontaxable source for the expenditures in question, thereby entitling the defendant to a verdict of not guilty.

On this issue a recent case decided by the Fourth Circuit Court of Appeals is informative, instructive, and persuasive. In *United States v. Bethea*, 537 F.2d 1187 (4th Cir. 1976), the defendant was convicted of income tax evasion wherein the government utilized the net worth theory. The defendant was convicted after a bench trial before the Honorable John A. MacKenzie of two counts of violation of 26 U.S.C. § 7201, the same section as involved in this case. The government proved that the defendant Bethea had expended more money than he

declared as income during the indictment years. The defendant Bethea, however, testified that his recently deceased brother Vernon, apparently a drug peddler in New York City, had left him sealed envelopes which contained between \$53,000 and \$54,000 in cash. The government also presented evidence concerning a likely source of income, to wit: desultory employment as a carpenter during the years in question, which the District Court credited. The trial judge found "the defendant's assertions to be inherently incredible and not worthy of belief". There was also evidence that Bethea at an interview with a special agent stated that he had received only \$2,000 to \$3,000 in gifts or inheritances during the relevant period.* The Fourth Circuit, after quoting the cautions which the Supreme Court has enunciated in *Holland v. United States, supra*, reversed the conviction on the grounds that the Government failed to offer evidence sufficient to establish Bethea's guilt beyond a reasonable doubt. Significantly, the Fourth Circuit stated:

"It is not necessary that we believe Bethea's story to reverse his conviction. He is not required, even under the net worth theory, to prove his innocence; the Government must establish his guilt beyond a reasonable doubt."

The Fourth Circuit found the likely source finding of the District Judge to be "clearly erroneous", 537 F. 2d at 1191. The Fourth Circuit also stated:

"We cannot sustain this conviction upon a mere speculation that Bethea might have made a lot of money unlawfully. The short answer is there is no evidence of substantial earned income—either lawful or unlawful, that can account for the increases in net worth."

* We will append as an appendix to our reply brief a reproduction of the District Court memorandum which is not otherwise reported.

Finally, the Fourth Circuit stated that even though Bethea have lied to the special agent, it is insufficient to establish guilt.

The similarities between these cases on each and every issue presented is astounding. The defendant Gay was tried at a time prior to the decision in *Bethea*. The decision of the Fourth Circuit is a reflection of the quite proper uneasiness of Circuit Courts to sustain a conviction on circumstantial evidence which employs a theory which requires "the exercise of great care and restraint" and which requires review "bearing constantly in mind the difficulties which arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation", *Holland v. United States*, *supra*, quoted at *United States v. Bethea*, 537 F. 2d at 1188 and which prompted the Fourth Circuit to state, "We are convinced that the government failed to establish guilt beyond a reasonable doubt", *id.*

The fact that Bethea waived a jury and the defendant herein had a jury trial presents no inherent difficulty procedurally. If, on all the evidence, a reasonable doubt exists or, if on all the evidence there must be a reasonable doubt in a reasonable mind, the conviction cannot stand, irrespective of whether the factfinder is judge or jury. See *United States v. Taylor*, 464 F. 2d 240 at 242-243 (2d Cir. 1972).

As stated in *Curley v. United States*, 160 F.2d 229 at 233 (D.C. Cir. 1946) by Judge Prettyman, quoted with approval in *United States v. Taylor*, *supra*:

"[I]f, upon the whole of the evidence a reasonable mind must be in balance as between guilt and innocence, a verdict of guilt cannot be sustained."

POINT IV

Other Errors Require A New Trial.

In any complicated criminal case things occur from time to time which prejudice the defendant and so too here. In this trial things occurred which severely prejudiced the defendant Gay in this close case and which require this Court, even if we are incorrect in all that we have stated before, to order a new trial. The first of these errors was the prosecutor's appeal to the jury in summation to convict the defendant on the grounds that he had a likely source of income from his printing business, when the government's investigation disclosed no such state of facts and no proof was in the record which would support such an inference. The second of these errors was in the failure of the trial court to instruct the jury that if they believed the defendant's evidence concerning cash accumulation that such cash accumulation would not be a taxable source of income for the indictment years 1967, 1968 and 1969 *only*.

We have previously pointed out that the government proved no likely source of income and instead relied on the proposition that it was negating probable sources of non-taxable income. The government had done an extensive investigation of the defendant's little printing business and its expert agents concluded that this was not a likely source of non-taxable income. We have included these government reports in our supplemental appendix at pages 949-980 which was court Exhibit 27 during the trial (see Supplemental Appendix p. 965 quoted at p. 25, *supra*). Nevertheless, within a minute of the commencement of the prosecution's summation, the prosecutor made the following remarkable comment:

"There is some traces of evidence in this case as possibly where this income came from. We know he had a printing business. You could speculate that this income came from the printing business. There was a hint of testimony that the defendant may have been in partners at one time in Gay's Lounge with his brother. I believe Lorraine Russo testified it was her understanding they were partners at one time but the defendant denies this and again this is just a hint, just speculation." (Tr. 772-3)

This constituted double-barrelled prejudice. In the first instance, the prosecutor was urging a conviction on speculation and hint*—in the second, urging a conviction on the grounds that the printing business was a source of undeclared taxable income when he knew (Supplemental Appendix pp. 965) that that was not so. Surely a foul blow! See *Burger v. United States*, 295 U.S. 78, 88 (1935). Coming so quickly and passing so fast we concede no objection was made. Because, however, it attempted to explain away the most serious deficiency in the government's proof, that is, the failure to show a likely source, the failure to negate nontaxable sources, and the failure of the government on the entire record to show undeclared taxable income during the prosecution indictment years, it severely prejudiced the defendant and standing by itself, amounts to plain error entitling the defendant to a new trial.

It is undisputed that one of the hotly contested issues in this case was the existence or non-existence of the cash accumulation of the defendant. The court, in its charge to the jury, at Transcript page 881, presented the factual question concerning the cash accumulation. However, the court stated to the jury:

* Absolutely forbidden! See Devitt & Blackman, *FEDERAL JURY PRACTICE AND INSTRUCTIONS*, §1114 "The jury will remember that a defendant is never to be convicted on mere suspicion or conjecture."

"If there is a cash accumulation and you believe that there is a cash accumulation, then, of course, that is not a taxable source of income for the years 1967, 1968, 1969."

This was most serious plain error to the extent the court did not include the indictment years 1970 and 1971. In effect, it instructed the jury that even if they believed the evidence, it was not to be considered as explaining the discrepancy for the final two years.

Finally, the charts were inaccurate and prejudicial. "... [B]are figures have a way of acquiring an existence of their own, independent of the evidence which gave rise to them." *Holland v. United States*, 348 U.S. at 128. The court will recall the considerable dispute during the trial of the available cash on hand of the defendant at the beginning of the first prosecution year, 1967. This disputed fact is reflected in the government's final analysis (government exhibit 159), in the net increases or decreases in bank accounts and cash on hand. The accuracy of the cash on hand figure could in large part, explain the expenditures made. The government, however, did not even credit the defendant with an available \$2,000.00 for expenditures during the prosecution period, but instead chose to make a meaningless accounting entry of a credit for \$2,000.00 cash on hand for each year of the prosecution period (see government exhibit 141). Thus, even if the defendant had advised the revenue agents of the considerable cash hoard, if the government had treated it the same way, it would have made no difference in the ultimate figure arrived at, since for each year \$2,000.00 was added and subtracted in determining the excess of expenditures over available sources of funds.

Additionally, government exhibit 159 was labeled in such a way to severely prejudice the defendant without a showing by

the government of the ultimate fact which it was required to prove. Here we are speaking of the government label on the figure which combined the expenditures in excess of funds with the taxable income reported by the defendant. The government chose to label this "Total Taxable Income". We have previously demonstrated the failure of the government to show either by a likely source or by negating nontaxable sources, the fact that the expenditures came out of currently taxable income. Hence this label was totally inappropriate and assumed the very fact which the government was required to, but did not prove. As stated in *Lloyd v. United States*, 226 F. 2d 9 at 17 (5th Cir. 1955):

"A trial court is charged with grave responsibilities in such instance to insure that an accused is not unjustly convicted in a 'trial by charts,' however impressive the array produced . . . Whenever possible, such charts should be confined in their preparation to strictly mathematical computations, subject to detailed explanation upon the trial by the testimony of expert government witnesses, and they should not be encumbered by impressive, conclusory captions as 'Overstatement of Merchandise Purchases', 'overstatement of Delivery Expenses', 'Unreported Cash Receipts of Lloyd's Bakery', 'Unreported and Undeposited Cash Receipts Invested in United States Savings Bonds', 'Unreported Net Income of Mr. E. C. Lloyd', income tax unreported and unpaid by Mr. Lloyd, such as were used on the government charts here in dispute. While a prosecution witness may testify as to such conclusions from his mathematical computations, we think the danger in permitting the unrestricted use of such phrases upon charts results from a jury's natural tendency to accept such unsworn, conclusory verbiage as authentic, primary proof, instead of purely in summarization and explanation of sworn testimony or of authenticated documentary evidence,"

In addition to this, the government summary chart (government exhibit 159, App. 911) was mathematically incorrect to the extent that it deducted in the sources of funds portion, the taxable portion of capital gains from the capital gains transactions in each of the indictment years. The defendant was reporting income on a cash basis. In any particular indictment year then, a capital gain from the sale of securities carried with it a tax liability for the capital gains tax. The government deducted from sources the capital gains tax in the same year in which the capital gains transaction took place when it is obvious that such liability does not attach and such payment is not required to be made until April 15 of the following year when the tax return is due. Thus, it was legally and mathematically incorrect to deduct in 1967 the capital gains tax due April 15, 1968 on the capital gains transaction listed in calendar year 1967. This error is carried through each of the taxable years. The defendant is not credited with having for example, in 1967, available funds which he did have available to him until April 15 of the following year. This is further evidence of a fact to which the court made reference in referring to the "sloppy manner of proving" the tax liability of the defendant (758). It also casts grave doubt on the ability of the government expert to make the required analysis when he was inaccurate regarding so plain a proposition.

The cumulative effect of these errors in this close case requires a new trial.

Conclusion

For the reasons set forth in Points I through III above, the judgment of conviction should be reversed. For the reasons set forth in Point IV, the court should order a new trial.

Respectfully submitted,

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Dated: Buffalo, New York,
October 3, 1977.

R. William Stephens,
Of Counsel.

AFFIDAVIT OF SERVICE BY MAIL

State of New York)
County of Genesee) ss.:
City of Batavia)

RE: U.S.A.
vs Joseph J. Gay
No. 77-1369

I, Leslie R. Johnson being
duly sworn, say: I am over eighteen years of age
and an employee of the Batavia Times Publishing
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10 Lafayette Square, Buffalo, New York 14203

Leslie R. Johnson

Sworn to before me this

3rd day of October, 19 77

Patricia A. Lacey

PATRICIA A. LACEY
NOTARY PUBLIC, State of N.Y., Genesee County
My Commission Expires March 30, 1979

